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IN THE

Supreme Court of the United States

October Term 1962.
No. 528

R. A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE, LOS ANGELES DISTRICT,

Petitioner,

vs.

MONOLITH PORTLAND CEMENT CO.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

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SUBJECT INDEX

Preliminary Statement .....

Statute Involved .....

Questions Presented .....

Statement .....

Argument .....

Conclusion .....

TABLE OF AUTHORITIES CITED

CASES

	PAGE
California Portland Cement Co. v. Riddell, 3 A. F. T. R. 2d 438, mod. on app. 297 F. 2d 345	10
Commissioner v. Halquist, 291 F. 2d 49	10, 11
Dragon Cement Co. v. United States, 244 F. 2d 513, cert. den. 355 U. S. 833	4, 5, 6, 9, 10
James v. United States, 366 U. S. 213	4, 7
Longhorn Portland Cement Co. v. United States, W. D. Tex., 8-26-61, pend. 5th Cir. No. 19910	10
Monolith Portland Cement Co. v. United States, 168 Fed. Supp. 692, 269 F. 2d 629	4, 5, 6, 9, 10, 11
Portland Cement Co. of Utah v. United States, 6 A. F. T. R. 2d 5062, reaff'd 9 A. F. T. R. 2d 758	10
Riverside Cement Co. v. United States, 2 A. F. T. R. 2d 6175	10
United States v. Cannelton Sewer Pipe Co., 364 U. S. 76	1, 6, 7, 8, 9, 10, 11, 12
United States v. Portland Cement Co. of Utah, 293 F. 2d 826	5

MISCELLANEOUS

67 Congressional Record, par. 3, pp. 3018-3019	3
Hearings before the Committee on Finance on the Revenue Act of 1943, 78th Cong., 1st Sess., pp. 527-528	3
1 President's Materials Policy Commission (Paley Report) "Resources for Freedom," pp. 3-4	2
Revenue Ruling 61-17, 1961-5, IRB 10	8
Revenue Ruling 280, 1953, 2 Cum. Bull. 41	8
Senate Finance Committee Report No. 903, and House Report (Ways & Means) No. 939, 87th Cong., 1st Sess.	12

PAGE

Senate Report No. 52, 69th Cong., 1st Sess., pp. 17-18 3

Senate Report No. 627, 78th Cong., 1st Sess., p. 23, 1944 Cum Bull. 991 4

STATUTES

Act of October 20, 1951, Ch. 521, Sec. 319 4

Act of September 14, 1960, Sec. 4 6

Internal Revenue Code of 1939, Sec. 23(m) 3

Internal Revenue Code of 1939, Sec. 23(n) 3

Internal Revenue Code of 1939, Sec. 114(b)(4)(A) 3, 5

Internal Revenue Code of 1939, Sec. 114(b)(4)(B) 3, 4, 6, 7, 10

Internal Revenue Code of 1939, Sec. 114(b)(4)(B)(iii) 8

Public Law 86-781 6

Public Law 87-312 12

38 Statutes at Large, Ch. 16, pp. 114, 166, 173-174 3

65 Statutes at Large, pp. 452, 497 4

74 Statutes at Large, pp. 290, 291-293, 1018 4

74 Statutes at Large, p. 1017 6

TEXTBOOK

18 New York University Institute on Federal Taxation (1960), p. 543, Rustigan, Calculation of Percentage Depletion: What Is Income 8

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BRIEF FOR RESPONDENT IN OPPOSITION.

Preliminary Statement.

As this Court noted following review of the legislative history of percentage depletion in *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76, 81 (1960):

> "In summary, mineral depletion for tax purposes is an allowance from income for the exhaustion of capital assets. Anderson v. Helvering, 310 U. S. 404 (1940). In addition, it is based on the belief that its allowance encourages extensive exploration and increasing discoveries of additional minerals to the benefit of the economy and strength of the Nation. We are not concerned with the validity of this theory or with the statutory policy. Our sole function is application of the congressional mandate. . . ."

Ours is truly a mineral civilization—a civilization which stands or falls on its capacity to produce staggering amounts of mineral products.[1] No country on earth owes more to minerals than does the United States; no country is more vitally concerned over the question of minerals exhaustion than is the United States. American national policy has always been to encourage the development of natural resources. From the original land grants and bounties to settlers, through the mining laws, railroad grants, water and reclamation laws to the present national minerals program, there has been a consistent encouragement of natural resources development by the Government.

"In its wisdom," Congress has determined that liberal incentives to encourage full development of all of America's mineral resources are desirable and that percentage depletion is an effective incentive as well as an equitable method of taxing only mineral income and not the capital which is being consumed.

The respondent's premise, upheld by the courts below, is that the Treasury must obey the plain congressional mandate. Congress—not this Court—is the proper forum for vindication of the Treasury's contrary premise. In any event, this matter is unimportant. The tax revenue involved in all pending cement cases is about one million dollars.

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[1] In 1950, the United States consumed 27 billion tons of mineral materials or 30,000 pounds per citizen. This 1950 demand will be doubled by 1975. (President's Materials Policy Commission (Paley Report), "Resources for Freedom," Vol. I, pp. 3-4.)

Statute Involved.

The pertinent statute — the Internal Revenue Code of 1939 — provides: (1) A reasonable allowance for depletion of "mines, oil and gas wells, other natural deposits and timber" as a deduction in computing net income (Sec. 23(m), (n)); (2) that such deduction for "mines and other natural deposits" shall be computed as a stated percentage of the "gross income from the property" (Sec. 114(b)(4)(A)); (3) that the term "gross income from the property" means "the gross income from mining" (Sec. 114(b)(4)(B)); and, (4) that:

> ". . . the term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also *the ordinary treatment processes normally applied* by mine owners or operators *in order to obtain the commercially marketable mineral product* or products . . ." (Sec. 114(b)(4)(B)).[2] (Italics ours.)

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[2]Beginning with the first income-tax statute in 1913 (c. 16, 38 Stat. 114, 166, 173-174), Congress has provided a depletion deduction from income for exhaustion of metal mines and other natural deposits. In 1926, "In the interest of simplicity and certainty of administration" (Sen. Rep. No. 52, 69th Cong., 1st Sess., pp. 17-18), Congress initiated percentage depletion for oil and gas. The basic concept of percentage depletion was that "an arbitrary percentage of the gross selling value" of the mineral (the depletion base) should be allowed as the deduction. (Cong. Rec., Vol. 67, Par. 3, pp. 3018-3019.) Later, in 1932, percentage depletion was extended to metal mines; and the deduction fixed at 15% of "the gross income from the property"—a trifle less than the 17½% of actual sales receipts such miners had previously been receiving under discovery depletion. (Shepherd Report, 1930). In 1943, when (contrary to its prior practice) the Treasury began to interpret its 1932 Regulations so as to restrict the phrase "gross income from the property" to conventional extractive mining processes (Hearings before the Committee on Finance on the Revenue Act of 1943, 78th Cong., 1st Sess., pp. 527-528), Congress amended the statute, expressly providing that "mining" should also include all ordinary processes required to obtain the "commercially

Questions Presented.

1. Taxpayer obtained the first salable mineral product — cement — from its otherwise non-marketable type of limestone by applying the ordinary treatment processes normally applied by miners of such deposits. Is such cement the "commercially marketable mineral product" Congress specified as the base for computing the allowable depletion deduction in Section 114(b)(4)(B) of the Internal Revenue Code of 1939?[3]

2. If this narrow question of statutory interpretation ever were an open one, has it not now become moot as to this taxpayer by the 1960 amendment of the statute and *res judicata*, and, under the doctrine of *James v. United States*, by the taxpayer's interim reliance upon *Dragon Cement* and the first *Monolith* case as the "existing law" for the cement industry?

marketable mineral product". The Senate Finance Committee Report, which explained the addition of Section 114(b)(4)(B) to the Code, states that:

> "The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would *normally apply to obtain a marketable product* should be considered *as a part of the mining operation*. . . ." (Emphasis supplied.) Sen. Rep. 627, 78th Cong., 1st Sess., p. 23, 1944 C. B. 984.

In 1951, percentage depletion was extended to "calcium carbonates" and "chemical grade limestone", the type of natural deposit involved here. (Act of Oct. 20, 1951, c. 521, 65 Stat. 452, 497, Sec. 319.)

[3] The Government presented the same question in *Dragon Cement Co. v. United States*, 244 F. 2d 513 (1 Cir., 1957), but this Court denied certiorari, 355 U. S. 833 (1957). The present parties litigated the same question on the same facts in the first *Monolith* case, *Monolith Portland Cement Co. v. United States*, 168 F. Supp. 692, S. D. Cal. 1958. On appeal, the Government "accepted" an adverse finding, 269 F. 2d 629, 632-633 (9 Cir., 1959), and did not seek certiorari. Congress has eliminated the question for post-1960 tax years, by amending the statute. 74 Stat. 290, 291-293, 1018.

Statement.

During 1952, the respondent (hereafter called Monolith) operated a plant at Monolith, California, where it obtained a salable mineral product[4]— cement — from an otherwise non-marketable type of limestone,[5] by applying the ordinary treatment processes normally applied by mine owners and operators in the branch of the mineral industry[6] having similar deposits. [R. 171.]

The district court held[7] that Monolith's operations fell squarely within the Congressional definition of

[4]R. 393, p. 4; see also authorities collected in *Dragon Cement Co. v. United States*, 244 F. 2d 513, 518 (1 Cir., 1957), *certiorari denied*, 355 U. S. 833 (1957).

[5]"Limestone" is a general term used to describe the entire range or series of rocks which consist principally (50% or more) of calcium carbonate [R. 94-97]. There are many different kinds and types of limestone. *United States v. Portland Cement Co. of Utah*, 293 F. 2d 826, 828-830 (10 Cir., 1961). Here, as in the first *Monolith* case, the District Court found that Monolith's type of limestone was either "calcium carbonates" or "chemical grade limestone" and not "stone" or "marble" limestone under Section 114(b)(4)(A) [R. 172]. The Court of Appeals expressly approved such finding. (301 F. 2d 388, 497.) Although the Government has not challenged such factual classification of Monolith's deposit, it insists upon calling it "stone" and using composite, general "limestone" statistics which do not differentiate the common "stone" limestone from the "calcium carbonates" limestone. The assumption of such facts by the Government, contrary to the record and findings below, is necessary to its argument. In passing, it is interesting to compare the Government's present effort to piece together a national "limestone" industry and market (Pet. pp. 3-5) with the sworn admission below that "We know of no 'limestone industry' nor any designation by it for rock of the type mined by the plaintiff." [R. 96.]

[6]Like the metal mining industry, the cement industry has always been recognized and classified as one of the "mineral industries" by all the authorities, including the Bureau of Mines. [R. 393, p. 37; R. 409.]

[7]The district court had first found that the factual issues of the present case were the same as those of Monolith's prior tax year, decided adversely to the Government in *Monolith Portland Cement Company v. United States*, 168 F. Supp. 692, S.D. Cal. 1958, aff'd 269 F. 2d 629 (9 Cir., 1959).

"mining" in Section 114(b)(4)(B) [the applicable depletion statute] thus entitling Monolith to compute the depletion allowance for exhaustion of its deposit in accordance with the statutory formula provided therein [R. 182], after Government counsel carefully distinguished the "individual profitability" question presented by the Government's pending petition in *Cannelton*[7] from the "marketability" question in this case. [R. 200-208.]

The court of appeals affirmed, holding *Cannelton* to be "distinguishable" and pointing out that in *Cannelton* the taxpayer had by-passed the available local market for fire clay while here, based upon a complete factual record, there was *no* market (profitable or unprofitable) for Monolith's type of limestone until it was processed into cement. (301 F. 2d 488, 495.) Following this Court's holding that such cases were "distinguishable" from *Cannelton*, the court below also held that the *Dragon Cement* and first *Monolith* cases were the "existing law" for those few cement companies which did not elect a kiln-feed depletion base in accordance with the 1960 amended depletion provisions of the Internal Revenue Code.[8] (301 F. 2d 488, 496.) In addition the court held that the Government's failure to seek certiorari in the first *Monolith* case[9] and Mono-

[7] *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76 (1960). See the Government's Petition for Certiorari in *Cannelton*, pp. 5, 12-13, claiming that the "profitability" issue in *Cannelton* was "discrete" and "entirely distinct" from earlier cases including the cement cases.

[8] Section 4, Act of September 14, 1960, P.L. 86-781, 74 Stat. 1017.

[9] The Government pressed the "marketability" question hard on the district court as the threshold question of the first *Monolith* case [R. 305-308], declaring that *Monolith* was the most

lith's reliance thereon under the doctrine of *James v. United States* (366 U. S. 213), precluded the Government's retroactive roll back of Monolith's depletion base to some nonsalable theoretical intermediate product. (301 F. 2d 488, 497.)

Argument.

I. The question assertedly presented — as to the scope of the statutory definition of "mining" in Section 114(b)(4)(B) of the 1939 Internal Revenue Code — is no longer of substantial importance to the administration of the Internal Revenue laws. The enactment of the 1954 Internal Revenue Code and the amendments of 1960 have deprived this area of all but academic interest. Further, as the Government concedes, the "potential revenue" in controversy in this entire area of depletion litigation has shrunk over 98%, or from "close to a billion dollars" in 1960 (Reply Brief for the United States, p. 4, *Cannelton*) to less than fourteen million dollars today.[11] (Pet. pp. 15-16.) Since the incidence of the moribund question allegedly presented is narrow and steadily diminishing, the case is not appropri-

important depletion case "in a good many years", and that the Government viewed it as a "test case" and "was trying to get to the Supreme Court" regardless of the expense of thorough factual development. [R. 309-310.] However, after the evidence was in and limestone non-marketability established, the Government did not thereafter even contest the findings that the market for limestone was negligible and that cement was Monolith's first commercially marketable mineral product from its deposit. 168 F. Supp. 692, 694; 269 F. 2d 629, 632-633.

[11] Even this figure is grossly inflated. Respondent challenges the Government's representations that the decision below is "applicable" to all other pending depletion litigation involving many other industries and that the amounts "involved" approximate $13,000,000. (Pet. pp. 15-16.) However, the statistics the Government refers to cannot be verified on this record.

ate for certiorari under the Court's criteria for questions of national importance.

2. The Government's assertion that the Ninth Circuit's decision is "in conflict" with the holding in *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76, "in a context which is indistinguishable" (Pet. p. 6) is untenable. As shown by this Court's opinion, in *Cannelton* there was (as taxpayer conceded) an available local market for fire clay both in Indiana and also 7 miles across the river in Kentucky. In fact, over 60% of all the fire clay produced in Indiana was sold in crude form. Taxpayer deliberately by-passed such market, and instead, fabricated[12] its fire clay into expensive moulded sewer pipe, claiming a depletion allowance some 20 times that of its neighbors who sold their fire clay. This Court held that such sales showed that fire clay was customarily sold in crude form in such market (§114(b)(4)(B)(iii)),[13] and that the statutory phrase "commercially marketable" referred to

[12] Cement (like fire clay) is the binding agent, which, when mixed by the fabricator with water (and aggregate), becomes concrete, "a plastic mass which is formed by machines into the shape of the finished ware desired." (*Cannelton*, 364 U. S. 76, 79). The articles fabricated from fire clay (pipe, tile, brick, etc.) are in direct competition with similar articles fabricated from concrete. Monolith does not fabricate such articles, or even produce the concrete from which they are fabricated. Instead, like the ordinary Indiana fire clay miner, Monolith sells its first marketable product—cement—to fabricators.

[13] In contrast, for many years the Treasury took the position that "calcium carbonates and shale mined for use in the cement industry" are not customarily sold in the form of the crude mineral product." However, Revenue Ruling 280, 1953-2 C. B. 41 (in effect for the tax year in question and at the time *Cannelton* was decided) was revoked a few months ago. Rev. Rul. 61-17, 1961-5, IRB 10. See also: Rustigan, *Calculation of Percentage Depletion: What is Income*, 18 N.Y.U. Institute On Federal Taxation 543 (1960).

an available commercial market where the mineral product was customarily bought and sold in that form; rejecting the Seventh Circuit's theory that an essential element of "commercially marketable" was profitability to the individual taxpayer. The Court expressly stated that the non-marketability cases cited by the taxpayer (including the first *Monolith* case) were not "apposite" and were "on their facts" "distinguishable" (364 U. S. 76, 89).

The district court below found that the facts here (mineral deposit, processes and available market) were identical to the facts in the first *Monolith* case. [R. 169-172.] The Government did not challenge this. Since this Court itself held the first *Monolith* case to be "distinguishable" from *Cannelton*, how could the Ninth Circuit err in holding this second *Monolith* case "distinguishable" from *Cannelton* on such unchallenged findings of identity?

3. The Government's claim that despite the obvious factual distinctions the decision of the Ninth Circuit is in conflict with *Cannelton* is itself in conflict with its prior representations to this Court. Two years ago the Government said that the question presented in *Cannelton* "... is discrete from that raised by the Government's petition in *United States v. Merry Brothers Brick & Tile Co.*" (*Cannelton* petition, p. 5), and that the issue in *Merry Brothers* "was the same in all relevant respects" as *Dragon Cement* (*Cannelton* petition, p. 13.) Finally, the Government conceded that *Dragon Cement* had decided the question of what were "ordinary treatment processes"[1] (*i.e.*, "mining")

[1] "[I]t is now settled that most of the ordinary treatment processes used in reducing the limestone to cement, *i.e.*, 'crushing', 'grind

against it (*Cannelton* petition, p. 14.) This Court recognized the distinction between the earlier cases (such as *Dragon Cement*, *and Cannelton*, and held such earlier cases to be "distinguishable" (364 U. S. 76, 80.) Today the Government asks the Court to overrule the very cases *Cannelton* held "distinguishable" on the strength of some of the dicta in *Cannelton*.

4. Contrary to the Government's present assertion (Pet. pp. 9, 13-16) the decision below is *not* in conflict with the decisions of other courts of appeal. Instead, the Ninth Circuit's decision is in accord with every case in every circuit (before and after *Cannelton*) which has presented the applicability of the statute and the question of the proper depletion base for this important branch of the mineral industry.[13] The cases the Government says are in "conflict" do not present even the question the Government says is in issue here. *Commissioner v. Halquist*, 291 F. 2d 49 (7 Cir., 1961), presented the "individual profitability" question.

ing", "sintering", etc.) which the Government now scores as "manufacturing" processes were expressly specified by Congress as "mining" processes in Section 114(b)(4)(B).

[13] *Dragon Cement Co. v. United States*, 244 F. 2d 513 (1 Cir. 1957), *certiorari denied*, 355 U. S. 833 (1957); *Monolith Portland Cement Co. v. United States*, 168 F. Supp. 692, S.D. Cal. 1958, aff'd 269 F. 2d 629 (9 Cir., 1959); *Riverside Cement Co. v. United States*, 2 AFTR 2d 6175 (S.D. Cal. 1958); *California Portland Cement Co. v. Riddell*, 3 AFTR 2d 438 (S.D. Cal. 1958), incl. on appeal following taxpayer's election of kiln-feed cut off under 1960 legislation, 297 F. 2d 345 (9 Cir., 1962); *Portland Cement Co. of Utah v. United States*, 6 AFTR 2d 5082, remanded for consideration of "ordinary treatment processes" applied by cement rock (limestone) miners 293 F. 2d 824 (10 Cir., 1961), and reaffirmed by district court 9 AFTR 2d 758, pending 10th Cir., No. 7028; *Lonestar Portland Cement Co. v. United States*, W.D. Tex., 8 AFTR 2d, pending 5th Cir., No. 19010.

There, it was unprofitable for the taxpayer to sell its rough-cut dolomite dimension-stone blocks in the available market. However the taxpayer bought some of these rough blocks itself from other miners to finish into veneer stone (294 F. 2d 49, 50). The Court held that the taxpayer could not, consistently with *Cannelton*, then claim there was not an available market for such blocks. Compare such situation with the finding here [R. 173][16] that in the principal marketing area available to Monolith,[17] the market for limestone like Monolith's was negligible unless it was processed to obtain cement. In *Virginia Greenstone Co. v. United States* [App. C to Pet. pp. 47-56], another dimension-stone (greenstone) case, the Fourth Circuit points out that "The cogent fact is that the taxpayer is in direct competition with other producers of dimension stone". *Greenstone* simply reaffirmed *Halquist*, and held that a dimension-stone producer cannot obtain a different depletion treatment than his direct dimension-stone competitors simply because his unique dimension-stone is quarried from a green rock not available to his competitors.

5. As previously noted, Monolith does not fabricate its cement into the concrete articles which compete with fabricated fire clay articles, such as sewer pipe. In-

[16]Incorporating Finding X from the first *Monolith* case, 168 F. Supp. 692, 694 (S.D. Cal. 1958).

[17]Which the Government below claimed included California, Nevada, Utah, and Arizona [R. 92]—an area many times larger than the Indiana-Kentucky area in *Cannelton*.

stead. Monolith sells its cement, which is then used as an ingredient of concrete by fabricators. This situation illustrates the unreasonableness of the Government's position here. Following *Cannelton*, Congress expressly rejected the Government's attempted retroactive application of its construction of *Cannelton* to the clay industry, and provided that for pre-*Cannelton* tax years such fire-clay miner-manufacturers should be allowed $1.25 ton (Act of September 25, 1961, P. L. 87-312),[18] instead of the 20¢ ton allowance reflected in this Court's opinion (364 U. S. 76, 89). Such statutory allowance is twice the 63¢ ton allowance reflected in the judgment below, and some nine times the 14¢ ton allowance the Government advocates here. Application of the Government's theories would mean that fire-clay fabricators who admittedly by-pass the market and engage in post-marketable fabrication, would get a depletion allowance nine times greater than those miners—like Monolith—who sell the first mineral product obtainable from their deposit (cement) which is then fabricated by concrete pipe and block manufacturers to compete with fabricated fire clay articles.

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[18] The committee reports reflect that Congress strongly disagreed with the Treasury as to the scope of *Cannelton*, and that the legislation was designed to prevent the Treasury's retroactive application of its construction, which Congress denominated "a completely new policy." Sen. Finance Committee Report, No. 903, and House Report (Ways & Means) No. 939, 87th Cong., 1st Sess.

Conclusion.

The issue presented by the petition was correctly decided by the court below. There is no conflict of decisions and no need for further review. In any event, the asserted issue is unimportant and the case is not appropriate for certiorari.

Dated: November 13, 1962.

Respectfully Submitted.

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